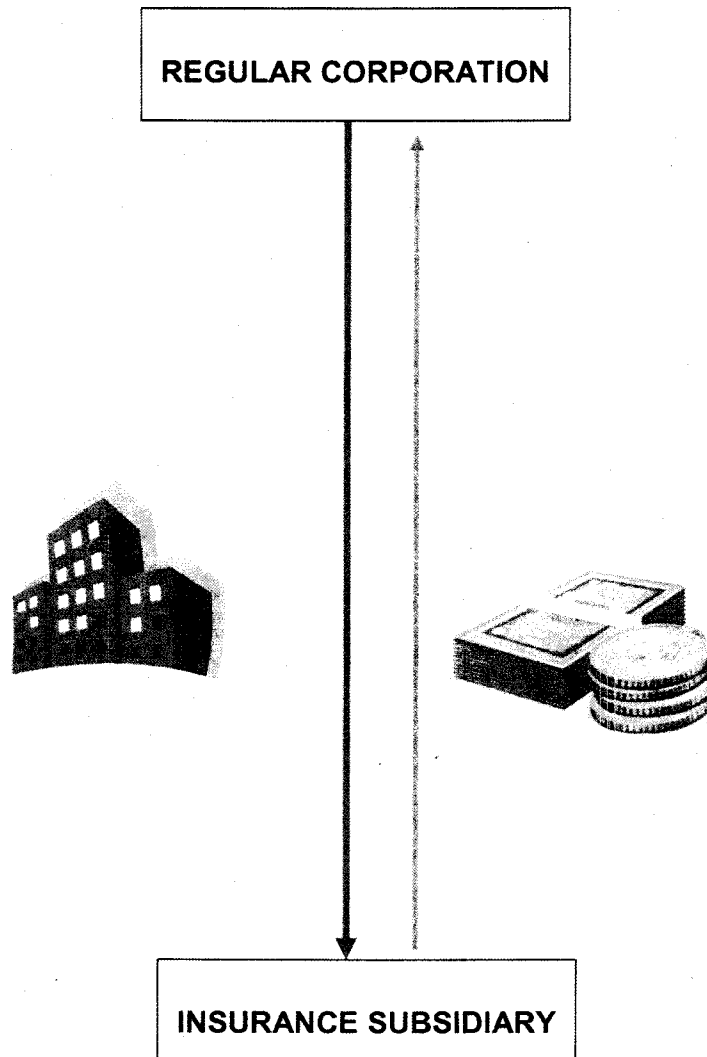


Exhibit "A"

OVERSTUFFING

In 1997, Regular Corp. bought building for \$100,000. In 2007, Reg. Corp. forms Insurance Sub. and transfers building to Insurance Sub. At the time of transfer, the building is worth \$500,000. At time of the transfer, the \$400,000 is not taxed because taxation is deferred (assume a qualifying IRC §351 transaction). [See Exhibit B]

## **PROBLEM AREAS EXISTING UNDER CURRENT LAW**

**Ex. 1:** Insurance Sub. sells the building for \$500,000. No tax is paid on the \$400,000. Why?

- Since Insurance Sub. pays insurance premium tax under Title 33, no corporate tax (or any other tax) on the growth is permitted.
- If Insurance Sub. had been a regular corporation, tax on the \$400,000 would be paid under Title 15, Chapter 31.

**Ex. 2:** After the sale, the Insurance Sub. pays a \$400,000 dividend to the Regular Corp. No tax, or very little tax, is paid on the \$400,000 dividend. Why?

- Reg. Corp. takes a dividend received deduction to offset the deduction it received.
- The deduction would range from \$320,000 to \$400,000.

**Ex. 3:** Insurance Sub. is not domiciled in Montana (but pays premium tax elsewhere) sells building and invests the proceeds. Insurance Sub. pays no dividend to Regular Corp., does not liquidate, but indefinitely defers payment of dividend to Regular Corp.

- No ability for DOR to treat a portion of accumulated earnings and profit from such a passive investment as income (currently has this ability-- as does IRS) as it could with a regular corporate subsidiary.

## **HOW SB 211 ADDRESSES THE ABOVE PROBLEMS**

**Initial Transfer/Ex. 1:** Section 4 could require the immediate recognition of gain on the \$400,000 if the building was not used in the Insurance Sub's regular trade or business. If the building was used in the Insurance Sub's regular trade or business, tax is not paid until the building is ultimately sold. Provision does not apply if the insurance company is not "over-stuffed".

**Ex. 2:** Depending on how over-stuffed the Insurance Sub is (Section 2), the deduction taken by Regular Corp. is limited. In other words, the more "stuffed" the Insurance Sub, the less of a deduction Regular Corp. may properly claim. Provision does not apply if the insurance company is not "over-stuffed".

**Ex. 3:** If the Insurance Sub is over-stuffed to the worst degree (Regular Corp. would not be entitled to any deduction under Section 2), DOR could require Regular Corp to report a deemed dividend. Provision does not apply if the insurance company is not "over-stuffed".